

## Internal Revenue Service

Department of the Treasury  
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Person To Contact:

, ID No.

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CC:PSI:B01 – PLR-140005-07

Date:

February 29, 2008

X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Trust A =

Trust B =

Trust C =

Trust D =

Trust E =

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Trust F =Trust G =Trust H =Trust I =Trust J =Trust K =A =Estate =Court =

Dear :

This responds to a letter dated September 6, 2007, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code (Code).

Facts

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X elected to be taxed as an S corporation effective Date 1. At the time of the S corporation election, X believed that all of its shareholders were eligible shareholders of an S corporation, including Trust A, Trust B, Trust C, Trust D, Trust E, Trust F, and Trust G, all shareholders of X at the time of the S corporation election. However, X represents that there is no record that the current income beneficiary of Trust A, Trust B, Trust C, Trust D, Trust E, Trust F, or Trust G timely filed the appropriate election under section 1362(d)(2) to be treated as QSST. As a result of the failure to file the elections, X's S corporation election was inadvertently invalid. On or before Date 2, all of the shares held by Trust A, Trust B, Trust C, Trust D, Trust E, Trust F, and Trust G were transferred to eligible S corporation shareholders.

On Date 3, A, a shareholder of X, died. On Date 4, the estate of A transferred shares of X to Trust H and Trust I. X believed that Trust H and Trust I were eligible grantor trust S corporation shareholders. However, Trust H and Trust I did not qualify as grantor trusts eligible to be S corporation shareholders because the trust agreements provide for the distribution of corpus to someone other than a single beneficiary. Effective Date 5, Court approved the modification of Trust H and Trust I to eliminate the ability of Trust H and Trust I to distribute corpus to anyone other than the named income beneficiary of Trust H and Trust I. As a result of this modification, X represents that Trust H and Trust I will qualify to be a QSST after Date 5.

At the time of the S corporation election, Estate was a shareholder of X. On Date 6, Estate transferred shares of X to Trust J and Trust K. X represents that there is no record that the current income beneficiary of Trust J or Trust K timely filed the appropriate election under section 1362(d)(2) to be treated as QSST. On or before Date 7, all of the shares held by Trust J and Trust K were transferred to eligible S corporation shareholders.

X represents that its invalid election and subsequent termination events were inadvertent, unintended, and not the result of tax avoidance or retroactive planning. X also represents that since receiving shares of X and thereafter, Trust A, Trust B, Trust C, Trust D, Trust E, Trust F, Trust G, Trust J and Trust K have complied with the requirements under section 1361(d), which defines a QSST.

### Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more

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than 75 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under section 1362(d)(2) will be treated as a trust described in section 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of section 678(a)) of that portion of the QSST's S Corporation stock to which the election under section 1361(d)(2) applies. Under section 1361(d)(2)(A), a beneficiary of a QSST may elect to have section 1361(d) apply. Under section 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of section 643(b) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1361(c)(2)(A)(i) provides that, for purposes of section 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1362(f) provides, in relevant part, that if (1) an election under section 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361 (b) or to obtain shareholder consents, (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in ineffectiveness, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to section 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the ineffectiveness, the

corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

### Conclusion

Based solely on the facts submitted and representations made, we conclude that X's intended S corporation election was invalid because of the failure of the respective current income beneficiary of Trust A, Trust B, Trust C, Trust D, Trust E, Trust F, and Trust G to file QSST elections. We further conclude that the ineffectiveness was inadvertent within the meaning of section 1362(f). Moreover, had X's S corporation election been valid, it would have terminated when shares of X were transferred to Trust H and Trust I, ineligible shareholders; similarly, X's S corporation election would have terminated when shares of X were transferred to Trust J and Trust K. We conclude that these terminations would have been inadvertent within the meaning of section 1362(f).

We further conclude that under section 1362(f), X will be treated as an S corporation from Date 1 and thereafter, provided that Trust A, Trust B, Trust C, Trust D, Trust E, Trust F, and Trust G qualify as QSSTs, and X's election to be an S corporation was otherwise valid and was not terminated under section 1362(d). Accordingly, the shareholders of X must include in income their pro rata share of the separately stated and nonseparately computed items of X as provided in section 1366, make any adjustments to basis as provided in section 1367, and take into account any distributions made by X as provided in section 1368. If X or its shareholders fail to treat X as described above, this letter ruling will be null and void.

Therefore, X will be treated as continuing to be an S corporation from Date 1, and thereafter, provided that a QSST election is filed for Trust A, Trust B, Trust C, Trust D, Trust E, Trust F, Trust G, Trust H, Trust I, Trust J and Trust K with the appropriate service center within 60 days of the date of this letter. A copy of this letter should be attached to the QSST election.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X is otherwise eligible to be treated as an S corporation or whether Trust A, Trust B, Trust C, Trust D, Trust E, Trust F, Trust G, Trust H, Trust I, Trust J or Trust K are eligible to be treated as a QSST.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/s/

Dianna K. Miosi  
Chief, Branch 1  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes

cc: